THE SUCCESSES AND FAILURES OF THE FIRST AND SECOND BANKS OF THE UNITED STATES[1]

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WRITING of the Second Bank of the United States, Professor Dewey says

> It is difficult to find in the experience of this institution any lessons of importance which may be of special service in the preparation of a plan for a large national central bank at a later period, when business methods have been transformed by the railroad, the telegraph, and by the development of corporate enterprise, to say nothing of the change in banking law through the general substitution of national supervision for state control.

The point is well taken. Conditions to-day are essentially different from those which existed in the period covered by the life of either of the United States banks. Nevertheless, their history has at least this value for the advocates of a central bank —it proves the superiority of a central bank over any other system of banking then existing in the United States, and in some respects over any other system ever existing in the United States.

I

In relating the successes and failures of the two banks, it must always be kept in mind that our knowledge of the operations of the first bank is exceedingly limited. This is due to the fact that almost all the reports of its operations have disappeared. Even Professor Holdsworth's account, although it tells us everything that is known about the first bank, does not permit us to

[1] Based on *The First and Second Banks of the United States*, by John Thom Holdsworth, Ph. D., and Davis R. Dewey, Ph. D. Washington, Government Printing Office, 1910. Publications of the National Monetary Commission, Senate doc. no. 571, 61st Cong., 2d session.

speak with any certainty about most of its operations. In the next place, it must be remembered that in the different circumstances of the country at the different periods of their existence, the history of the two banks is very unlike. The second bank was established principally for the purpose of facilitating a return to specie payments after the suspension of 1814. The first bank never had any such task. The efforts necessary to perform it brought down upon the second bank the deadly hostility of the state banks, which were always in friendly relations with the first bank. Moreover, the number of these local banks was much greater during the period in which the second bank existed than it was before that period. Again, the second bank carried on larger operations and over a much wider territory than did the first. This is shown by the fact that the first bank possessed only eight branches, all of them on the Atlantic seaboard, while the second bank had twenty-five branches, many of them in the interior. The character of the business of the two banks was also very different. The first bank loaned for the most part to merchants in the great seaports who had duty bonds to pay; the second bank loaned much more extensively to merchants in the interior. Again, the population and wealth of the country in the second period were vastly in excess of that existing in the first period. It follows that the career of the second bank was essentially different from that of the first.

Still, in many fundamental particulars the history of the two was similar. Above all, in the methods necessarily employed in regard to the currency problem of the country the two banks were at one. The fundamental currency problem in both cases was to secure a sound currency by guaranteeing the continuance of specie payments. To do this, it was necessary to diminish the immense volume of state bank issues, thus putting an end to their depreciation and inconvertibility. Each of the United States banks was what Bagehot considers the Bank of England to be, the centre of a "single banking reserve system." This was so not because they held the specie reserves of the state banks, but because those banks never troubled themselves to keep any adequate specie reserves. Instead, they trusted to the United States banks to protect them in case of unusual demands

for specie. Since this was the case, the banks of the United States were compelled in their own interest to see to it that specie payments were not suspended. The second bank had a further reason for such solicitude in the existence of a charter provision which compelled it to pay twelve per cent interest per annum on all its obligations which it refused to discharge in specie on demand.

Hence the national banks were bound to exercise some control over the business and especially the issues of the local banks. Both of them did exercise such control. The means employed by both banks were identical, consisting, as Gallatin says, " in receiving the notes of all those which are solvent, and requiring payment from time to time without suffering the balances due by any to become too large." To do this the banks of the United States had to be creditors of the state banks. This they were enabled to be, first, because they received the government revenues as the depositaries of the goverment, and second, because of their possession of branches. As depositaries of the government they received immense quantities of state bank paper. These were then presented to the state banks for payment. In case control was exercised by a branch, it was done by issuing the notes of the branch in the neighborhood of a state bank, and receiving state bank notes on deposit for these issues. The branch then presented the state bank notes to the issuing bank for redemption. In both cases, the state bank possessed no means of obtaining branch bank notes to anything like the amount necessary to act as a set-off to its own issues. The state banks were not receivers of the revenue, and they could not get possession of any considerable quantity of branch bank notes because these served as an excellent means of remittance for individuals who wished to forward funds to other parts of the country. Persons holding state bank notes were always willing to exchange them for paper of the bank of the United States, while nobody wished to exchange notes of the United States bank for state bank notes. Consequently, the branches always had the means of checking the state banks, and exercised it.

The means at the disposal of the big banks were efficient to

meet the end in view, but it must be noted that their employment forced both the big banks and the little ones to determine the volume of their discounts and loans, and the amount of their issues, by a consideration which had nothing to do with correct banking. The banks should have discounted with no other consideration in view than the need of the business community for banking facilities. This was not done, and in so far the entire banking system of the day was a mistaken one. This does not detract from the banks' success, however, in solving what after all was the most important problem in the currency situation so far as the people of the United States were concerned, namely, the possession of a sound and uniform currency. Moreover the policy of the banks secured a national currency in the place of a large number of local currencies. The existence of these numerous state bank currencies was one of the insuperable difficulties of the government and the people when no bank of the United States existed. State bank paper being payable only where issued, it follows that there was no medium common to the entire country except during the existence of one or the other of the big banks. Not only so, but the state bank issues were badly depreciated when distant from their places of issue. As a consequence, the government lost large sums of money in handling this paper. So did individuals, most of them having no means by which they could present the notes for redemption. The Banks of the United States furnished their own notes, which circulated from one end of the country to the other, and by their plan of checking state bank issues confined the latter to the neighborhood of their place of issue. The paper currency of the United States was sound and uniform under these conditions. The paper of the United States banks was an excellent currency. All their notes were receivable at Philadelphia, as well as at the issuing office; they were all receivable in payments to the United States; five-dollar notes were usually received by any branch, no matter where issued, and all notes were receivable on deposit. Meanwhile the state bank issues were restricted in quantity and kept within the localities where they were issued. Nor was this all. The paper was fairly elastic, being issued in answer to the demands of

borrowers who needed it to transact legitimate mercantile business, and ceasing to circulate when these transactions were completed. It can be asserted truthfully that the people of the United States at these periods possessed a paper currency which was decidedly superior to any other existing in the United States before the establishment of the present national banking system.

Another success of first importance on the part of the second bank was secured in the field of inland exchange. By its purchases of inland bills it furnished the farmers and merchants of the west and south with loans at a cheaper rate than could be supplied by the local banks. It could do this as a consequence of its branch system and its large capital. That these means made it possible to loan money cheaply in these sections would seem self-evident. Nevertheless, the fact of its furnishing cheaper accommodations in exchange, cheaper than the state banks in the west and south was denied at the time. But the experience of borrowers in those sections after the expiration of the charter of the second bank proved conclusively that they received better rates from the big bank. The Kentucky banks, for example, at once raised the rate of inland exchange to five per cent, though the rate of the Bank of the United States had usually been one per cent, and never over two and a half per cent. The Kentucky banks justified their action, when objection was made, on the ground that they could not make arrangements "with collecting banks in the south to furnish drafts at any definite rate or at any fixed time after collection." Moreover, the funds of the bank buying the bill had frequently to lie idle at the collecting bank because drafts upon the east could not be procured, and these were the only means of transfer of funds allowed by the collecting bank at New Orleans. Hence a loss of interest on the funds. Under the circumstances the Kentucky banks argued that five per cent was not too high a rate. They could not deny, of course, that this was a much heavier burden upon trade than before. Moreover, they admitted that the Bank of the United States had given better accommodations; but that, they said, was due to its national character.

This was the correct explanation. The Bank of the United States did not need to make arrangements with other banks to collect its bills or furnish other drafts, since all the transactions connected with its exchange operations took place through its own offices. Nor did its funds lie idle, for there was always use for them at some one or other of its offices, and if they were not needed where they happened at the moment to be, they were transferred without delay to places where they were needed. It is evident that in this respect the old bank of the United States was vastly superior to the state banks, or indeed to any system which does not include branches. It is equally evident that the purchase of inland bills at a low rate was of enormous benefit to merchants and farmers in the south and west, and a very important means in aiding the development of that country. "It is undoubtedly true," says Dewey, "that one of the chief services of the bank to the commercial world lay in its ability to furnish exchange at low and fairly uniform rates." It is quite as true that similar advantages would be afforded to-day by a central bank with branches.

The services of both banks of the United States as government agencies were never denied. Gallatin said over and over again that the first bank furnished a safe depositary for the government, that it transmitted the treasury funds from one part of the country to another "instantaneously," and that it greatly facilitated the collection of the revenue. It must be added that the first bank was not bound by its charter to transfer the treasury funds without recompense. In 1800 the government passed an act authorizing the bank to hold the public deposits, and after this the bank did transfer the funds without charge. The same arrangement existed in the case of the second bank and was provided for in its charter. It was bound to transfer the public funds within the states and to distribute them to the public creditors without making any charge for the service. It was also required by a later law to act as commissioner of loans and as pension agent for the United States.

The actual services of both banks were briefly as follows: 1. They received and kept the revenues of the government. 2. They transferred the government funds without charge within

the limits of the United States. 3. They disbursed the government's funds to the holders of government bonds when these were paid off. 4. They disbursed the pension fund. 5. They acted as commissioners of loans for the government. All this was done without expense to the government.

The government also enjoyed the advantage of having a safe depositary for its funds. These were placed in the offices of the bank by collectors of customs and taxes, by postmasters and by land-office agents. The bank then became immediately responsible to the secretary of the treasury for every cent thus deposited. Secretary Woodbury, a bitter enemy of the second bank, admitted that the government never lost a dollar through the agency of the Bank of the United States, whereas it is well known that it lost considerable sums both when these funds were deposited in the state banks and when it undertook to care for them itself, without mentioning the expenses necessary for taking care of them even when no loss was incurred. Certainly the banks of the United States furnished the safest and the cheapest depositaries of government funds that this country has ever known.

The greatest usefulness of the banks to the government consisted in the transfer of the public funds. The revenues of the government were deposited in the offices of the bank, and were then subject to the draft of the treasurer. He was bound, however, to give notice to the bank so that it might have time to make the transfers without embarrassment to itself. This was done by sending to the cashier a weekly list of drafts drawn by the government, and after June, 1829, a daily list of the government warrants issued, stating the sums which the government needed, the places at which it needed them, and the times of payment. The bank then met the needs of the treasury without inconvenience to itself or expense to the government. In this respect the banks of the United States were the cheapest and best agencies the government ever possessed. Without them it has always been compelled to pay for its transfers, whether these were carried out by itself or by state banks. Yet the bank frequently made money by the transfers. This was the result of its branch system, its extensive issues of notes

which were current from one end of the union to the other, and its system of inland exchanges. No state bank possessed any of these advantages, nor is it possible to secure them except through the medium of a great central bank with branches.

A further advantage of the handling of the funds by the banks is to be found in the effect upon the business community. Under the present system of keeping the government funds, large sums of specie are frequently locked up in the treasury instead of being at the service of the commercial interests. Again, in the payment of the public debts, large sums are frequently thrown upon the market at a time when they are not needed. During the existence of the banks of the United States these difficulties were not experienced. The bank held the government deposits, and employed them in the discount of business paper, thus keeping them in use by the community. Again, when payments had to be made on account of the public debt, the banks discounted long beforehand on the receipt of the bonds to be redeemed, which were deposited by merchants to secure their loans. Thus the payment of the debt was gradual.

From what has been said, it will be apparent that the successes of the banks of the United States depended first of all upon the system of branch banks connected with the parent office at Philadelphia. It was through the possession of these that they were able to create a sound and uniform paper currency, to restrict the over-issues of state banks, to furnish an elastic currency, which was issued only at the demand of merchants on the security of business paper, and which was retired when the transactions upon which it was based ceased. It was through their branches that they were able to establish a system of exchange which furnished cheap loans to the south and west. It was thus that they were able to meet any legitimate demand for loans in any part of the United States where they had branches. For the branches kept the bank management informed as to the localities where money was needed, and a transfer of funds could take place to those localities at once. This is an advantage which no bank without branches can possibly have. Not only so, but the loans so furnished

were at a lower rate than was possible under any other system. This is another great benefit of a bank with branches. It tends to equalize the rate of exchange in differents parts of the country.

II

We may now consider the failures of the banks, failures which in some cases were due not so much to the banks as to the conditions of the day. The first and most serious of these was the failure of these banks of the United States to secure an arrangement with the local banks by which the two systems might act in unison in the face of a threatened panic. This criticism will apply more specifically to the second bank, for the first bank of the United States did have agreements at times with the great state banks. This was due to the small number of the state banks at the time, and the excellence of their management. When the second bank was in existence, the state banks were much more numerous and scattered, while their management was by no means impeccable. Moreover, the hatred of the state banks for the second bank would have made any agreement impossible. In any case, no such agreement existed. No concerted action was possible. The result was that there were constant flurries in the money market, and in time of panic, the banks generally refused accommodations, thus intensifying the panic instead of checking it. A difficulty of this sort probably would not arise to-day, and certainly not if there existed a large central bank with the duty imposed upon it of safeguarding the financial interests of the country.

Another failure sprang out of the banks' efforts to check the issues of the state banks. As a consequence of this effort, the banks were compelled to trade in the same localities as the state banks. This is particularly true of the second bank, which did a very large business in the south and west. But it was extremely difficult to do legitimate banking in these sections, because the need in them was not for banking facilities, but for capital, for long loans on the security of real estate. The bank was not able to avoid these difficulties. Much of its capital in the latter years of its existence was tied up in accommodation

paper at long dates in these distant offices. This was bad banking. In case of a panic, the bank would have found itself in a very dangerous situation indeed.

Another failure in the case of both banks was their inability to make their note issues strictly convertible. The first bank never made any effort, except for a brief period, to pay all its notes at any and all its offices. Consequently, they were slightly depreciated when at any great distance from the branch which issued them. The case of the second bank was similar, though that bank for most of its existence did redeem its five-dollar notes at all its branches, no matter where issued. The depreciation was always small, and frequently did not affect the mass of the people, since the smallest denomination of the bank's paper was receivable at par wherever there was an office of the bank, and all the notes were receivable at par in payments to the government.

The failure which most affected the interests of the second bank was the failure to control its offices. Whether such a difficulty existed in the case of the first bank it is impossible to say. The managers of the second bank, however, frequently found it impossible to control the branches in the policy followed in regard to loans and issues. The difficulties in the way of adequate control were probably insuperable at that time. The central office could not determine minutely the policy which was to be pursued by the branches. That had to be left to the local directors, who alone were sufficiently acquainted with the business men and the business needs of their localities. Moreover, the lack of railroads and telegraph lines made it impossible for the central board to act with the necessary promptness in sending instructions. Consequently, only a general line of policy could be indicated to the branches, and then their managers had to be left to carry it out in their own way. Often this way was directly opposed to the instructions sent. Occasionally the local directorates set the parent board at defiance, and carried out their own policy in direct violation of specific orders. This was true even when the offices were subject to the most stringent supervision, which was exercised only in the last half of the bank's existence. Thus at Hartford, in 1826, the branch

management disobeyed orders, and lost a large sum of money as a consequence. There were similar cases of disobedience at Pittsburg, Portland, Portsmouth, Nashville, New Orleans, Lexington, Louisville, and even at an office so close to the central office as the New York branch. The consequence was a large amount of bad banking, especially at the western and southern offices.

The cause of the failure to control the offices lay almost entirely in the circumstances of the day. The difficulties of communication, as already pointed out, made it impossible to exercise sufficient control. But above all, it was impossible to secure intelligent men for the local directorates, who knew anything of legitimate banking methods. This was the great difficulty. To-day none of these causes of failure exist. Even at that time, provided the branches had been in closer proximity to the central office, it is altogether likely that adequate control would have been exercised. The experience of the Indiana Bank, founded in 1834, shows that such control was possible.

The value of a great central bank possessing branches would be much greater now than in the earlier history of our country. To the government it would furnish a convenience not otherwise obtainable in safeguarding and transferring the public funds. It would undoubtedly be able to furnish banking facilities in small communities where to-day this is scarcely possible and thus would tend to equalize the rate of interest throughout the United States. Such a bank as the holder of the single specie reserve of the country would make panics like that of 1907 impossible; it might issue notes on the basis of assets, and thus furnish an elastic currency which would avoid all the drawbacks of present national bank issues. In a word, a great central bank with branches is probably the only institution which will meet the present banking needs of the United States.